

IN THE UNITED STATES BANKRUPTCY COURT FOR THE
DISTRICT OF PUERTO RICO

In re:	:	
	:	
JOSE MENDEZ ROSADO and	:	Case No. 82-01460 (GAC)
ALEJANDRA BECERRA ESPINOSA	:	
	:	
Debtors	:	
	:	Chapter 7
	:	
MARIA LUISA CONTRERAS, TRUSTEE,	:	
	:	
Plaintiff	:	
	:	
v.	:	Adv. No. 94-0044
	:	
JOSE MENDEZ ROSADO, ET AL.	:	
	:	
Defendants	:	
	:	

MEMORANDUM OPINION AND ORDER

This matter is before the Court on the motion of the trustee for summary judgment brought under Fed.R.Civ.P. 56, made applicable to adversary proceedings in bankruptcy cases by Fed.R.Bankr.P. 7056, in connection with an adversary proceeding brought by the trustee against, among others, attorneys who represented the debtors in a state court action while this bankruptcy case was pending. The trustee seeks summary judgment against the state court attorneys, José Cuevas Segarra (hereinafter "Cuevas") and Antonio Concepción (hereinafter "Concepción"), as well as against their spouses and their conjugal partnerships. (Collectively, in this opinion, the Court may refer to Cuevas, Concepción, their spouses and their conjugal

partnerships as "the defendants".) The defendants, have also filed a joint cross motion for summary judgment against the trustee.

With respect to the defendants, in the trustee's third cause of action in her amended complaint she seeks turnover to the estate, pursuant to 11 U.S.C. § 542, of certain unauthorized post-petition transfers of property of the estate to Cuevas and Concepción. The defendants request summary judgment against the trustee claiming that the trustee's action must be brought under 11 U.S.C. § 549 and that the statute of limitations under this section has expired. In the alternative the defendants argue that they have acquired legal title to the estate property by prescription and that they may not now be ordered to turn over the funds under any section of the Bankruptcy Code. For the reasons stated below, the Court grants the trustee's motion for summary judgment and denies the defendants' joint cross motion for summary judgment.

FACTS

1. In 1981, prior to the filing of this petition in bankruptcy, the debtors filed a medical malpractice action (hereinafter "malpractice action") against Karl Horn, Julio Westernband and their respective insurance companies before the Superior Court of Puerto Rico, San Juan Part (hereinafter "Superior Court"), Case No. 81-3773(803).

2. On October 6, 1982, the debtors filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code.

3. Johnny Elias Rivera was appointed as the Chapter 7 trustee.

4. On July 6, 1983, the debtors filed an informative motion to amend their bankruptcy schedules to include the malpractice action as an asset of the estate.

5. On December 6, 1983, the debtors filed an application to retain Wilfredo A. Geigel, Esq. to prosecute the malpractice action.

6. The Court approved the debtors' application to retain Wilfredo A. Geigel, provided that any agreement reached in the malpractice action had to be approved by the Bankruptcy Court.

7. The debtors received a discharge in bankruptcy on June 13, 1984.

8. Elias Rivera later filed a report in which he advised of the pendency of the malpractice action before the Superior Court and indicated that the bankruptcy case could not be closed until the malpractice action was concluded.

9. Elias Rivera's appointment as trustee was terminated by the Bankruptcy Court and Hector Urrutia (hereinafter "Urrutia") was appointed as successor trustee.

10. On August 26, 1988, Concepción filed a motion on behalf of debtors, which indicated that Wilfredo Geigel had

resigned representation in the malpractice action and requested the appointment of Concepción and Cuevas as special counsel.

11. The application for employment was denied by the Bankruptcy Court without prejudice on September 7, 1988 for failure to comply with Federal Rule of Bankruptcy Procedure 2014.

12. After the denial of the application for employment, Cuevas wrote several letters to Urrutia regarding the necessity of being appointed by the Bankruptcy Court to continue representation of the debtors in the malpractice action. In the last letter, Cuevas indicated that the debtor had received a discharge after completing payments under a plan, that the case was closed and that the bankruptcy court had lost jurisdiction over the settlement of the malpractice action. Urrutia wrote back on the bottom of the letter stating that if what Cuevas was saying was correct, the Bankruptcy Court had lost jurisdiction. Urrutia suggested that Cuevas go to the Clerk's Office of the bankruptcy court to verify the information. (Translation Ours).

13. After the denial of the initial application for employment, no further applications were filed with the Bankruptcy Court requesting the employment of Cuevas or Concepción to represent the debtors in the malpractice action.

14. A stipulation was reached in the malpractice action and it was approved by the Superior Court by judgment dated February 21, 1989.

15. In May of 1989, Cuevas and Concepción were paid \$32,520 for their services in the malpractice action.

16. Neither the stipulation in the malpractice action nor the payments to Cuevas and Concepción were approved by the Bankruptcy Court.

17. On September 16, 1993, Urrutia resigned as trustee and Donald Walton was appointed as successor trustee.

18. On February 2, 1994, María Luisa Contreras was appointed as trustee, succeeding Donald Walton.

19. María Luisa Contreras, as trustee, commenced this adversary proceeding more than two years after the payments were made to Cuevas and Concepción.

20. The trustee contends that \$27,456 of the sum paid to Cuevas and Concepción is property of the estate and subject to turnover.

JURISDICTION AND PROCEDURE

The Court has jurisdiction over this proceeding pursuant to 28 U.S.C. § 1334(b) as a matter arising under 11 U.S.C. § 542 of the Bankruptcy Code. This is a core proceeding under 28 U.S.C. § 157(b) (2) (E).

STANDARD FOR SUMMARY JUDGMENT

Under Fed.R.Civ.P. 56(c), made applicable to bankruptcy proceedings by Fed.R.Bankr.P. 7056, summary judgment is proper if the pleadings, depositions, answers to interrogatories and

admissions on file, together with any affidavits, show that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law. Celotex Corp. v. Catrett, 477 U.S. 317, 322, (1986). On a motion for summary judgment, the inferences drawn from the facts presented must be viewed in the light most favorable to the party opposing the motion. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249 (1986). There is no genuine issue for trial if the record taken as a whole could not lead a rational trier of fact to find for the non-moving party. Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587 (1986).

DISCUSSION

Property of the Estate

The trustee seeks to recover \$27,456 of the post-petition payments made to Cuevas and Concepción in May of 1989 as proceeds of the malpractice action. Regarding the interaction between state law and bankruptcy law in determining what is property of the estate,:

[w]hether the debtor has a legal or equitable interest in property is a question of applicable nonbankruptcy law, usually state law. Once it is established that, under applicable nonbankruptcy law, the debtor has a legal or equitable interest in property as of the petition date, the question of whether that interest is estate property is strictly a question of bankruptcy law.

1 Robert E. Ginsberg & Robert D. Martin, Bankruptcy Text, Statutes, Rules, § 5.01[b][1] (3d ed. Supp. 1994) (footnotes

omitted).

In the present case, at the time of the filing of the bankruptcy petition, the debtors had a cause of action against certain doctors and their insurers. Under state law the debtors had a property interest in the malpractice action. Accordingly, whether the cause of action became property of the estate upon the filing of the bankruptcy petition, is determined only by bankruptcy law. The Bankruptcy Code indicates, with certain exceptions not applicable here, that the estate is composed of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). Thus, under this section, the malpractice action became property of the bankruptcy estate at the time of the filing of this petition. Any amounts subsequently paid to the debtors and their attorneys resulting from the stipulation reached in the malpractice action were also property of the bankruptcy estate as proceeds of property of the estate pursuant to 11 U.S.C. § 541(a)(6).

Necessity of Attorney Appointment to Represent Estate and
Necessity of Filing Application for Compensation to Receive
Payment for Services

Under the Bankruptcy Code, attorneys seeking to pursue a cause of action on behalf of the estate, must be appointed for this purpose by the Bankruptcy Court. The Bankruptcy Code provides that:

the trustee, with the court's approval, may employ one or more attorneys . . . that do not hold or represent

an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

11 U.S.C. § 327(a). In August of 1988, when Cuevas and Concepción submitted their application for employment, the Federal Rules of Bankruptcy Procedure provided that:

[a]n order approving the employment of attorneys . . . pursuant to § 327 . . . of the Code shall be made only on application of the trustee or committee, stating the specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to the best of the applicant's knowledge, all of the person's connections with the debtor, creditors, or any other party in interest, their respective attorneys and accountants. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, or any other party in interest, their respective attorneys and accountants.

Fed.R.Bankr.P. 2014(a).

Even after an order approving the employment of an attorney is entered, the attorney must file an application for compensation before the Bankruptcy Court in order to be compensated for services performed. In 1989 when Cuevas and Concepción received funds from the estate, the Bankruptcy Code provided that "[a]fter notice to the parties in interest and the United States Trustee and a hearing, . . . the court may award to a . . . professional person employed under section 327 . . . reasonable compensation for actual, necessary services rendered

by such . . . professional person, or attorney" 11

U.S.C. § 330(a)(1)-(a)(1)(A). The Federal Rules of Bankruptcy

Procedure also provided that:

An entity seeking interim or final compensation for services, or reimbursement of necessary expenses, from the estate shall file with the court an application setting forth a detailed statement of (1) the services rendered, time expended and expenses incurred, and (2) the amounts requested. An application for compensation shall include a statement as to what payments have theretofore been made or promised to the applicant for services rendered or to be rendered in any capacity whatsoever in connection with the case, the source of the compensation so paid or promised, whether any compensation previously received has been shared and whether an agreement or understanding exists between the applicant and any other entity for the sharing of compensation received or to be received for services rendered in or in connection with the case, and the particulars of any sharing of compensation or agreement or understanding therefor, except that details of any agreement by the applicant for the sharing of compensation as a member or regular associate of a firm of lawyers or accountants shall not be required. The requirements of this subdivision shall apply to an application for compensation for services rendered by an attorney or accountant even though the application is filed by a creditor or other entity.

Fed.R.Bankr.P. 2016(a).

Power of the Court With Respect to Compensation Paid to Professionals

The Bankruptcy Code provides that:

[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an

abuse of process.

11 U.S.C. § 105(a). One of the inherent powers and duties of a bankruptcy court relates to reviewing fees paid to professionals. In re E Z Feed Cube Co., Ltd., 123 B.R. 69, 73 (Bankr. D.Or. 1991). The Court in In re E Z Feed Cube Co., Ltd., held that the trustee could have funds turned over pursuant to 11 U.S.C. § 105(a), despite that the statute of limitations under § 549 had expired. The Court reasoned that:

[i]t is of the utmost importance that [the] court act to preserve the integrity of the bankruptcy system and to maintain public confidence therein. This court must regulate the conduct of its officers to ensure that such conduct complies with the Bankruptcy Code and Rules.

Id. at 74. The court also pointed out in a footnote that "[i]t must be remembered that no applications or notice were ever sent to creditors apprising any interested party or the court of the payments received by the defendant." Id. at 74 n.2.

In this case, after Attorney Geigel resigned representation of the debtors in the malpractice action, Concepción filed an application on behalf of the debtors with the Bankruptcy Court seeking the appointment of Cuevas and himself as special counsel in the malpractice action. The Bankruptcy Court found that the application did not comply with Federal Rule of Bankruptcy Procedure 2014. Accordingly, the application was denied. No application conforming with Fed.R.Bankr.P. 2014 was ever filed. Nonetheless, Cuevas and Concepción continued to represent the

debtors in the malpractice action.

The settlement ultimately reached in the malpractice action was not approved by the Bankruptcy Court, as required by Judge Lamoutte's Order, nor were any of the funds turned over to the Bankruptcy Court. Cuevas and Concepción received \$32,520 from the settlement of the malpractice action, \$27,456 of which is subject to this turnover action. The payment to Cuevas and Concepción was not made pursuant to an application for compensation before the Bankruptcy Court. Creditors and other parties in interest did not receive notice of a request for fees by Concepción and Cuevas. The payment was not approved by the Bankruptcy Court. Thus, the payments made to Cuevas and Concepción were improper as a matter of law. Under these circumstances, this Court finds that, irrespective of the statute of limitations under § 549, the trustee is entitled to turnover of the payments made to Cuevas and Concepción pursuant to 11 U.S.C. § 105(a).

Statute of Limitations for Filing Avoidance Actions Under § 549 Does Not Apply to Turnover Actions Brought Under § 542

Ordinarily, when an attorney receives unauthorized compensation from property of a Chapter 7 bankruptcy estate, the trustee could seek recovery of the unauthorized compensation under 11 U.S.C. § 549. This section allows a trustee to avoid an unauthorized transfer of property of the estate. In the present case, however, any attempt by the trustee to recover the post-

petition payments to Cuevas and Concepción under § 549 is clearly barred by § 549's two year statute of limitations.

The trustee in this case seeks to recover the payments made to Cuevas and Concepción under 11 U.S.C. § 542. This section provides that:

Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, . . . shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

11 U.S.C. § 542(a). Citing the legislative history of this section and case law, it is Cuevas and Concepción's position that 11 U.S.C. § 542 only applies to entities holding property of the estate on the date of the filing of the petition.

The Court notes that the statute itself refers to an entity in possession, custody or control of property "during the case". This suggests that application of the section is not limited to entities holding property of the estate on the date of the filing of the petition. Moreover, the Court finds that the legislative history of the statute is in conflict. While portions of the legislative history suggest that 11 U.S.C. § 542 only applies to entities holding property of the estate on the date of the filing of the petition, the legislative history also states that:

[s]ubsection (a) of this section requires anyone holding property of the estate on the date of the filing of the petition, or property that the trustee

may use, sell, or lease under section 363, to deliver it to the trustee.

(HR rep. No. 595, 95th Cong, 1st Sess. 369 (1977); S. Rep. No. 989, 95th Cong, 2d Sess. 84 (1978)). It further provides that, "[t]he section makes clear that any entity, other than a custodian, is required to deliver property of the estate to the trustee or debtor in possession whenever such property is acquired by the entity during the case. . . ." (124 Cong.Rec. H11096-97 (daily ed. Sept. 28, 1978); S17413(daily ed. Oct. 6, 1978); remarks of Rep. Edwards and Sen. DeConcini). Based on the language of the statute and the legislative history, the Court does not find the argument compelling that the statute, on its face or based on its legislative history, only applies to entities holding property of the estate on the date of the filing of the petition.

Cuevas and Concepción also argue that to allow the use of 11 U.S.C. § 542 to recover a post-petition transfer would obliterate the statute of limitations imposed by 11 U.S.C. § 549, since there is no statute of limitations found in 11 U.S.C. § 542. Cuevas and Concepción accordingly urge the Court to adopt the reasoning of the court in In re 31-33 Corp., 100 B.R. 744 (Bankr. E.D.Pa. 1989) and hold that the trustee may only proceed under § 549 and not under § 542.

In the case of In re 31-33 Corp., the court refused to allow a trustee to use § 542 to recover a \$13,890 post-petition

commission paid to a real estate broker pursuant to an order of the court. In that case, the real estate broker had not previously sought court appointment. And like the present case, the trustee's motion was brought more than two years after the payment to the real estate broker. The court noted that the broker was not aware of the requirement that she obtain court appointment. The court also found that two policy reasons strongly favored denying recovery to the trustee. These are that the trustee's broad powers should be subject to some time limitation and that allowing recovery under § 542 would obliterate the difference between § 542 and § 549. The court also went on to indicate that the equities did not favor allowing the trustee to recover since the trustee was appointed well within the limitation period under § 549 and the trustee had unexplained delays in presenting the motion. Accordingly, the court found that even if the motion were properly brought under § 542, there is an implicit 'reasonable period of time' limitation and it had expired.

This Court does not find the reasoning of In re 31-33 Corp., persuasive as applied to this case. In addition to the fact that the language of § 542 and portions of the legislative history strongly suggest that it applies to entities holding property of the estate during the case, it is also true that often there is more than one section that a trustee may proceed

under to recover unauthorized post-petition transfers. Although § 549 would be the most obvious section under which to proceed, if it were available, the trustee in this case could just as easily have sought relief under 11 U.S.C. § 362. This section does not have a statute of limitations, while a case remains open and may be used even when the § 549 limitation period has expired. See generally, In re Germansen Decorating, Inc., 149 B.R. 517 (Bankr. N.D.Ill. 1992).

Because unauthorized post-petition transfers may be recovered under sections other than § 549 and not be subject to the two year statute of limitations found in § 549, the difference between § 549 and other statutes allowing recovery of unauthorized post-petition transfers has, for all practical purposes, already been obliterated. Thus, the Court finds that § 549 applies to actions to recover property of the estate brought under § 549, but that it does not place a time limit on actions for turnover of property that may be brought under other sections, such as §§ 542, 105 and 362. Moreover, in this case the trustee was not appointed prior to the expiration of the two year statute of limitations found in § 549 and there have been no unexplained delays by the trustee in bringing suit. Thus, if there is an implicit "reasonable period of time" limitation for bringing suit under § 542, the Court finds that it has not expired.

The Court finds that the trustee may use 11 U.S.C. § 542 to seek turnover of the post-petition payments to Cuevas and Concepción. Thus, applying 11 U.S.C. § 542, the Court finds that Cuevas and Concepción are entities in possession, during the case, of property that the trustee may use under section 363 of this title. The \$27,456 received by Cuevas and Concepción is not of inconsequential value. Wherefore, the trustee is entitled to turnover.

Legal Title to the Property; Violation of the Automatic Stay

Cuevas and Concepción argue that if the Court finds that 11 U.S.C. § 542 is available to the trustee in seeking turnover, the Court should find that the funds are no longer property of the estate. Cuevas and Concepción argue that the trustee is not entitled to turnover of the funds because Cuevas and Concepción acquired legal title over the funds at issue by prescription pursuant to the Civil Code of Puerto Rico.

The Court finds that the defendants could not acquire legal title to the funds under a state law theory because when they acquired the funds the automatic stay of 11 U.S.C. 362 applied. The Bankruptcy Code provides that:

- (1) the stay of an act against property of the estate under subsection (a) of this section continues until such property is no longer property of the estate; and
- (2) the stay of any other act under subsection (a) of this section continues until the earliest of-
 - (A) the time the case is closed;
 - (B) the time the case is dismissed; or
 - (C) if the case is a case under chapter 7 of

this title concerning an individual . . . the time a discharge is granted or denied.

11 U.S.C. § 362(c). "The language of section 362(c) is clear and unambiguous. In the case of an act against property of the estate, the stay continues until the property is no longer property of the estate." 2 Collier on Bankruptcy 362-62, (15th ed. Supp. 1995).

In the present case, the debtors received a discharge of their debts, but the case remained open. Because the funds collected by Cuevas and Concepción had not been abandoned by the trustee, they were still property of the estate. The Bankruptcy Code prohibits "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." 11 U.S.C. § 362(a)(3). "The third paragraph of section 362(a) is directed to actions, whether judicial or private, seeking to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." 2 Collier on Bankruptcy 362-38 (15th ed. Supp. 1995) (footnote omitted). Moreover, it is irrelevant whether the debtors voluntarily made the transfer to Cuevas and Concepción. See In re Germansen Decorating, Inc., 149 B.R. 517 (Bankr. N.D.Ill. 1992). Thus, the actions by Cuevas and Concepción in taking possession of the funds were in violation of the automatic stay. Actions in taking possession of property of the estate in violation of the stay are generally void and

without legal effect, unless condoned by the court. I.C.C. v. Holmes Transp., Inc., 931 F.2d 984, 987-88 (1st Cir. 1991) (citations omitted). Therefore, the defendants may not now claim that they acquired legal title to the funds pursuant to a state law theory. As discussed by the Court in In re Germansen Decorating, Inc., 149 B.R. at 520, since there is no statute of limitations, while a case remains open, for recovery of property obtained in violation of the stay, the trustee is entitled to recover the payments made to Cuevas and Concepción.

Successor Trustee is Not Bound by Acts of Former Trustee

In Cuevas' answer to the trustee's motion for summary judgment, he raises for the first time the argument that the trustee, as a successor trustee, is bound by the acts and representations of the former trustee. He cites no legal authority for this proposition.

A successor trustee is the proper party plaintiff in an adversary proceeding against a former trustee for breach of fiduciary duty. See In re Elegant Equine, Inc., 155 B.R. 189 (Bankr. N.D.Ill. 1993). Because a successor trustee has the right to sue a former trustee for breach of fiduciary duty, the successor trustee can not be bound by the acts and representations of a former trustee.

In the present case, if the representations which Cuevas and Concepcion attribute to Urrutia were made, they were contrary

to law and the orders of the Bankruptcy Court. Accordingly, the present trustee, as a successor to Urrutia, is not bound by his alleged acts and representations.

CONCLUSION

Pursuant to 11 U.S.C. §§ 105(a), 542(a) and 362, the defendants will be required to deliver to the trustee, and account for, the \$27,456 of property of the estate.

ORDER

Wherefore, IT IS ORDERED that the trustee is granted summary judgment on the third cause of action. The defendants' joint cross motion for summary judgment is denied. The defendants, José Cuevas Segarra, his spouse, Amneris Martínez, and the conjugal partnership constituted between them and Antonio Concepción, his spouse, Agna Morales, and the conjugal partnership constituted between them are liable to the trustee on the third cause of action in the amount of \$27,456.

There being no just reason for delay, the Clerk shall enter judgment in favor of the trustee and against the aforementioned defendants on the third cause of action, in the sum of \$27,456 together with interest thereon at the legal rate from May 1989 until repaid.

The trustee is also granted costs attributable to the third cause of action in this adversary complaint. The trustee shall file a motion with a statement of costs within thirty days. The

defendants have thirty days to object. The trustee then has twenty days to reply. Once all motions related to costs are filed, the Clerk will refer them to Chambers. A hearing will be scheduled if necessary.

SO ORDERED.

Dated at San Juan, Puerto Rico, this _____ day of July, 1995.

BY THE COURT:

GERARDO A. CARLO
U. S. Bankruptcy Judge